Can Venture Thaw the IPO Ice Age?

BY BRET SWANSON

Government policy makers can add first-quarter initial public offering totals to their list of embarrassments. Federal Reserve deflation, the highest tax burden since World War II, and de facto nationalization of broadband access have slowed the economy and crashed markets. They have also shut the window on companies looking for public capital infusions.

LIFT OFF

In March, three key optical networking firms, two innovative semiconductor companies, and numerous software and biotech ventures withdrew their Securities and Exchange Commission S-1 filings. For the year, 79 IPOs have been withdrawn. Include December withdrawals by companies looking to go public in early 2001 and that number swells to 110. Only the March spin-off of Lucent's microelectronics group, Agere Systems (AGRa), could spare the quarter total humiliation. At $3.6 billion, it was the fourth largest IPO ever in dollar terms, but the offering was far from a success. Agere originally hoped to raise $6.5 billion for its operations, which include semiconductors, optical components, and tunable lasers.

Excluding Agere (pronounced "a gear"), 16 first-quarter IPOs raised just $4.5 billion. That's the worst showing since 1989 with just 12 first quarter offerings. And we know what happened to the economy in 1990. Since 1980, an average of 74 first-quarter IPOs have raised an average of $6.1 billion, unadjusted for inflation. Forgone proceeds from abandoned offerings total well over $10 billion this year.

From Optical Micro Machines, a maker of silicon micro-mirrors used in optical switching, to WaveSplitter, a young leader in wavelength division multiplexing, and from International Microcircuits, an upstart competitor to Texas Instruments, to Conexant's network chip spin-off, important companies are being turned away from the public markets. Even last month's feature company, Chorum Technologies, had to withdraw.

At the Optical Fiber Communications conference in Anaheim, Chorum's Mike Decelle told me that SEC rules discourage companies from leaving IPO filings in play until the market bounces back. Companies must periodically update those filings. And as telecom spending slows with the economy, it's likely that last quarter's revenues, which must be reported, are less than stellar. Few companies enjoy issuing new figures implying much lower valuations, so they go back "underground." The rules also prohibit companies on file from raising private capital while they wait to go public.

The IPO deep freeze is hardest on companies at the margin. Many have gone through several rounds of venture funding and need public money to continue, or to pursue new strategies. For companies like Chorum with exceptional products and a healthy cash position, however, postponing an IPO isn't the end of the line. Venture capitalists, in fact, would probably love to get one more shot at the leading firms before they exit the private realm.

Power has shifted from Wall Street to Silicon Valley. Venture capital vaulted from $60 billion in 1999 to $104 billion in 2000, funding 4,000 and 5,450 companies respectively. Four hundred forty-nine IPOs raised $64 billion in 1999, and 605 IPOs raised $165 billion in 2000. Though the private-public gap widened for the full year, venture money overtook IPO money in the fourth quarter of 2000. The *Forbes* venture capital roundtable estimates $40 billion in venture capital this year. If public markets continue to dawdle, venture capitalists could beat investment bankers for the whole year.

That's because VCs are closer to the entrepreneurs and technologies. With some 970 companies exhibiting at the optical fiber conference and tens of thousands more in wireless, biotech, and other industries, such understanding by the owners is crucial. The public markets are closed, but you wouldn't know it from the astounding number of venture-funded innovations in Anaheim.

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With investment banks and brokerages obsessed with Washington and Wall Street accounting, those who deeply understand technologies and the people behind them, namely the VCs, angel investors, and open IPO affinity groups—which function more like late-stage venture capitalists than like traditional public investors, will discount market gyrations and earn corresponding returns.

A new market architecture is emerging, hastened by the current downturn. Walter Wriston wrote that politicians and bureaucrats are in the twilight of their sovereignty. Less politely, they are on the verge of uselessness. The power shift away from Washington and Wall Street scares the establishment. They overreact. Fed Chairman Alan Greenspan asserts control and deflates the non-inflationary stock and IPO "bubble." Congress insists that we need wartime tax levels and micro-managed telecom networks. But Wriston remains largely correct. Private equity and open IPOs can overwhelm Greenspan's punctured public bubble. Entrepreneurs and their innovations can still win.

Sonata

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Smith Mountain Lake lies in the foothills of the Blue Ridge Mountains, an hour's winding, tumbling drive from convenience store or neon sign. On still summer days millworkers and tobacco farmers from Roanoke and Danville like to go there with their ice chests and portable TVs, pitch their tents among the dogwood and magnolia, and imagine what it might have been like to raise a family and erect a cabin and hunt for food among the parsimonious trees. At the lake's visitor center they can see sepia photographs of their ancestors and a few examples of the tools they used: A wooden scythe and a handmade lathe, a corn cutter, a rusted sausage stuffer. And over in the corner, seemingly more

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